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SUBJECT: The New Socialist Countryside One Year Later

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SUMMARY

1. (SBU) One year after its launch in October 2005, officials at all levels emphasize that the Central Government's New Socialist Countryside policy -- tagged by the State Council as China's top policy priority for 2006 -- should be understood as a long-term endeavor that will not offer immediate relief to rural residents. Rural experts welcome the focus on rural problems, but they worry that what are already insufficient resources are being misused by local officials for short-term political gain. Compounding the funding problem is the recent elimination of the agricultural tax, a move that has greatly compromised the ability of county governments to deliver social services such as education and health care. Officials and researchers maintain that non-farm income, derived from part-time work in urban areas or wage income in the countryside, provides the best opportunity for farmers to increase their incomes. Observers uniformly agree that despite recent gains, government efforts to boost consumption in the countryside and achieve more balanced development are constrained by low incomes and high precautionary savings in rural areas. END SUMMARY.

The New Socialist Countryside One Year Later

12. (SBU) With the launch of the New Socialist Countryside in October 2005, the Central Government, as in previous years, has focused much of its attention on the rural economy. Policymakers and rural experts emphasize that rural reform is a long-term endeavor, and that the current policy will not offer immediate relief to farmers. The following policy pronouncements from Beijing over the past year indicate that the Central Government, with an eye towards maintaining rural stability and balancing regional economic growth, places a great deal of importance upon the success of the New Socialist Countryside policy:

--October 2005: The Eleventh Five-Year Plan draft, adopted by the Fifth Plenary Session of the 16th CPC Central Committee on October 11, launched the New Socialist Countryside policy, which has five basic elements: (1) balancing urban and rural development, (2) developing modern farming techniques, (3) comprehensively deepening rural reforms, (4) developing public services in rural areas, and (5) increasing farmers' incomes (Ref A).

--November 2005: The Central Economic Work Conference, convened by the State Council and CPC Central Committee from November 29 to December 1, reiterated China's commitment to establishing the New Socialist Countryside as one of its goals for 2006 (Ref A).

--February 2006: China's State Council announced on February 21 that establishing the New Socialist Countryside would be the Central Government's top policy priority in 2006, unsurprisingly naming solving rural problems as its key objective for the third

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consecutive year (Ref B).

--March 2006: During the March session of the National People's Congress (NPC), the Central Government announced it would spend an additional RMB 42.2 billion (USD 5 billion) for agriculture, rural areas, and farmers in 2006. The 14 percent increase in expenditure prioritized rural infrastructure projects and subsidies for grain producers and farmers utilizing agricultural machinery (Ref C and D).

--September 2006: Premier Wen Jiabao declared at a rural reform conference that China is entering a third phase of reform that will build on the New Socialist Countryside and focus on local institution-building and governance (Ref E).

13. (SBU) Critics suggest that budget support for the policy remains inadequate. A researcher at the China Academy of Social Sciences (CASS) who also serves as a policy advisor to the Central Government said in June 2006 that while Central Government funding for rural programs is increasing, the allocation as a percentage share of the total budget remains relatively unchanged, and the expenditures are insufficient (Ref F). The advisor noted that the Central Government's budget to support agriculture, rural areas, and farmers increased to RMB 339.7 billion (USD 42.5 billion) in 2006 from RMB 293.5 billion (USD 36.7 billion) in 2005, but he lamented that the Central Government's overall budget expenditure has been increasing at an average of 17-18 percent in recent years, and the rural account should be viewed in that context. He also noted that 16 or 17 Central Government ministries and several layers of local government (county, township, and village) ultimately depend on New Socialist Countryside expenditures.

Funding Shortages and the Public Finance Crisis

¶4. (SBU) According to provincial and local government officials, lack of funding and poor coordination between ministries is detrimental to the provision of social services. County governments, primarily responsible for delivering social services such as education and health care, previously depended on the agricultural tax for their revenue. Since the elimination of the agricultural tax, however, county governments complain that the Central Government allocates only 30 percent of the resources they need to provide social services. The Director General of the Department of Rural Development at the State Council's Development Research Center (DRC) stated in June 2006 that recent studies by the DRC reveal that most county governments are not able to meet the modest funding levels required to implement the rural cooperative medical insurance program under the New Socialist Countryside. (Note: As outlined in Ref D, the Central Government announced it would spend RMB 4.7 billion (USD 600 million) on rural health during ¶2006. The Central Government provides a subsidy of RMB 20 per capita for the program, with an additional RMB 10 from provincial governments, RMB 6 from counties, and RMB 4 from townships. End Note.)

¶5. (SBU) In Northeastern China's Heilongjiang Province, for example, rural watchers expressed concern that funding shortages for social programs at the local level may undermine rural policy initiatives (Ref Q). Throughout China, officials worry that the burden on local governments will lead to a public finance crisis, with local governments tending to compensate for the funding shortfall by borrowing money from financial institutions. The Assistant Mayor of Chi Bi City in Hubei Province said in November 2006 that the public finance crunch is particularly acute in the rural areas in his district (Ref G).

Misuse of Limited Resources Undermines Implementation

¶6. (SBU) Further exacerbating the funding shortage

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problem is that New Socialist Countryside resources often are misused by local officials for their own short-term political gain. Leaders in many localities have misappropriated funds to build model villages as "image projects" in an effort to help their promotion prospects. Model villages -- with a cleaner environment, running water, renewable energy, and a more developed appearance -- are not necessarily misguided projects. Most model villages, however, are constructed with a local official's political gain in mind, and media reports as well as our discussions with officials and researchers over the course of numerous visits to rural areas suggest that these projects are not sustainable.

¶7. (SBU) The Central Government recognizes the model village problem and does not want local officials to abuse the New Socialist Countryside slogan for their own gain. Early in 2006 a Xinhua News Agency report warned about the dangers of model villages, characterizing them as a "disturbing phenomena" and "an opportunity for cadres to vie with each other for political achievements" (Ref I). Similarly, an editorial in the China Daily in November 2006 criticized model villages, stating that local government leaders want to "make political achievements to boost their chances of promotion" or "make profit for themselves" (Ref G).

¶8. (SBU) In Central Gansu Province, Embaffs visited a

model village of 27 housing units that serves as an example of one project that may promote a local government official's career but does little to advance economic development in an extremely poor region. The units are insufficient to house the nearly 300 families in the village, waste invaluable resources of the Provincial Poverty Alleviation Bureau (RMB 26,000 per house), and strain limited public finance coffers (Ref I).

Non-Farm Income Best Opportunity for Rural Residents

¶9. (SBU) Officials and researchers maintain that non-farm income, derived from part-time work in urban areas or wage income in the countryside, provides the best opportunity for farmers to increase their incomes. At the China Development Forum in March 2006, Liu He, Vice Minister, State Leading Group on Finance and Economic Affairs, stated that while implementing the New Socialist Countryside is an important task for the Central Government, policymakers must continue to promote urbanization in order to encourage surplus laborers to migrate to cities. Liu stated that as much as 55 percent of rural income (approximately RMB 1700) may be derived from part-time work. (Note: Provincial government officials routinely state that non-farm income accounts for 30 to 50 percent of rural incomes. End Note.)

¶10. (SBU) China's urbanization drive is attracting rural residents to cities at a breakneck pace. As a result, there are no figures to accurately reflect the size of the rural population. Rural experts agree that the idea that there are 800 million Chinese farmers is outdated, and conditions in the countryside demonstrate that the official migrant population figure, ranging from 120 million to 200 million workers, does not reflect the current situation. Our visits to the countryside in the past year suggest that most young men have departed to seek work in the cities, and interviews with farmers suggest that they are heavily dependant upon remittances from relatives living in urban areas.

¶11. (SBU) In addition to providing surplus labor, many rural areas are attempting to cultivate non-traditional agricultural products and identify other opportunities for non-farm income. Meetings with provincial government officials often focus on the need to modernize the agricultural sector, including promoting agro-processing. Visits to the countryside usually reveal that farmers are growing non-

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traditional crops such as mushrooms or beans from which they can earn a higher return. In some areas, in addition to farming, rural residents are engaged in the tourism sector to supplement their income (Ref H).

Consumption Lagging in the Countryside

¶12. (SBU) Observers uniformly agree that despite recent gains, government efforts to boost consumption in the countryside and achieve more balanced development are constrained by low incomes and high precautionary savings in rural areas. The urban-rural income gap continues to grow, with urban incomes exceeding three times rural incomes in 2006. Many economists believe the figure is really closer to six to one if account is taken of the reduced purchasing power caused by higher costs for services such as education, health care, and pensions in rural areas. Education and health care in particular continue to be a priority for farmers, and a major reason for

precautionary savings in the countryside is that farmers save to pay for school fees or for medical care. To alleviate these concerns, the New Socialist Countryside policy aims to provide free rural compulsory education for nine years and implement the rural cooperative medical insurance system, but anecdotal evidence to date indicates that the policy has fallen short.

¶13. (SBU) In Central China's Hubei Province, for example, rural incomes remain low and government policies have failed to boost consumption, according to Provincial Government officials (Ref G). Hubei's rural per capita income is below the national average at RMB 3099 (less than USD 400), and observers in Wuhan (Hubei's provincial capital) state that a sharp contrast exists between Wuhan, which is attracting large international retailers such as Wal-Mart, and Hubei's countryside, where branded companies are unwilling to venture due to a low rate of consumption.

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